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## CITATIONS

# In the Supreme Court of the United States

OCTOBER TERM, 1944

No. 451

THE CITY NATIONAL BANK & TRUST COMPANY, TRUSTEE, UNDER TRUST AGREEMENT WITH HAMILTON DEPOSITORS OF HAMILTON TRUST SHARES, PETITIONER

*v.*

COMMISSIONER OF INTERNAL REVENUE

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT*

## BRIEF FOR THE RESPONDENT IN OPPOSITION

### OPINIONS BELOW

The memorandum opinion of the Tax Court (R. 11) is not officially reported. The opinion of the Circuit Court of Appeals for the Tenth Circuit (R. 282) is reported in 142 F. 2d 771.

### JURISDICTION

The judgment of the circuit court of appeals was entered on May 13, 1944 (R. 290), and petition for rehearing was denied on July 7, 1944 (R. 292). Petition for a writ of certiorari was filed on September 9, 1944. Jurisdiction of this Court is invoked under Section 240 (a) of the

Judicial Code, as amended by the Act of February 13, 1925.

### QUESTION PRESENTED

Whether the circuit court of appeals properly found that the investment trust involved herein is an association taxable as a corporation within the meaning of Section 901 (a) of the Revenue Act of 1938 and the identical language of Section 3797 (a) (3) of the Internal Revenue Code.

### STATUTE AND REGULATIONS INVOLVED

These are set forth in the Appendix, *infra*, pp. 14–19.

### STATEMENT

The Commissioner of Internal Revenue found a deficiency in the income and excess-profits tax liability of petitioner's predecessor for the year ended April 30, 1939, and in its income tax liability for the year ended April 30, 1940 (R. 6–7). The case was submitted to the Tax Court on an agreed statement of facts (R. 52–56) incorporating a number of exhibits (R. 56–273), all of which facts were found by the Tax Court (R. 11). In addition, testimony was taken (R. 22–51) "to explain a little more fully the operation" of the trust (R. 24).

The Hamilton Trust, herein called the trust, was created by a written declaration of trust dated July 23, 1931, executed by Hamilton Depositors Corporation, herein called the corpora-

tion, the Guardian Trust Company of Denver, Colorado, and such persons as might from time to time purchase trust share certificates, herein called beneficiaries or investors (R. 12, 104). The International Trust Company of Denver, Colorado, herein called trustee, was substituted as successor trustee on March 10, 1934 (R. 3), but while this proceeding was pending in the Tax Court, The City National Bank and Trust Company of Kansas City, Missouri succeeded International as trustee on May 31, 1941 (R. 11), and was by order of the Tax Court substituted as petitioner (R. 10–11).

"The purpose of the Hamilton Plan", according to its prospectus, is to provide a method of purchasing through common stocks, an ownership interest in a diversified and carefully selected group of thirty leading American corporations" (R. 141). The agreement underlying this investment trust provides that the trustee, at the direction of the corporation, is to use monies supplied by the investors to pay for specified stocks, purchased by the corporation for the trustee (R. 106), and comprising the portfolio of the trust (R. 13, 195). Units purchased by the corporation are composed of an equal number of common shares of each of the companies named in the agreement (R. 108). A person may become an investor by application to the corporation accompanied by his first payment for an interest in the securities. The corporation then issues

a trust share certificate to the investor after it has been authenticated and recorded on the books of the trustee. (R. 12.) The payments received by the corporation, less its commissions, are deposited with the trustee's bank to the credit of the trustee (R. 13, 108).

The trust agreement contemplates that the stocks will be sold from time to time and the proceeds reinvested (R. 104, par. 1; R. 121, par. 13; R. 123–124, pars. 18–21). Although the agreement provides that there shall be "no right of substitution" of stock in the portfolio (R. 123, par. 18), paragraph 64 (R. 135) provides in part that:

> At any time that the Corporation shall decide that the portfolio then in effect is no longer in proper balance on account of changing conditions and/or eliminations, stock dividends and split-ups, it shall have the right to prepare a new portfolio and to offer to the Investors, individually and not collectively, a new Certificate based thereon. * * *

The trustee holds title to all funds (R. 126, par. 28), accounts to the corporation (R. 127, par. 34), and purchases additional units with the accumulated funds (R. 124, pars. 20–21). In its individual capacity, the trustee may contract with the corporation and any of the companies whose stock it holds either with relation to trust shares or otherwise (R. 128, par. 37); it has power to take any action deemed advisable in connection with the execution of the trust (R. 128, par. 39),

and the trustee may employ agents and attorneys in the execution of its duties under the trust (R. 129, par. 42). No individual liability attaches to the trustee (R. 114; R. 128, pars. 40–41; R. 129, pars. 45–46).

The income and profit from the operation of the trust are distributed and paid to the beneficiaries according to the number of units they hold or, in other words, the interest they have in the trust (R. 109, 111–112, 114–115). The beneficiaries or investors ordinarily have no voice in the management or operation of the trust (R. 19), and the only time that beneficiaries have a voice in the affairs of the trust is if and when the trust ceases to do business or to perform its functions (R. 132–134, par. 55 (a)). The voting power of the stocks is vested in the corporation (R. 122, par. 16). No personal liability attaches to the beneficiaries (R. 107, 114), and the right is afforded them to transfer, sell, and assign trust certificates or shares of the trust (R. 110).

The business done by the Hamilton Trust from its inception in 1931 as well as during the tax years in question has been very extensive. In the approximately eight years from its institution to August 31, 1939, $4,428,561 has been paid in on the issued certificates (R. 155) which have a face value of $14,986,667 (R. 155), and there has been purchased and deposited with the trustee a total of 85,770 shares of stock (2,859 shares of each of 30 stocks named in the portfolio) (R. 17). On

August 7, 1939, the market value of securities then held by the Hamilton Trust was $3,099,688 (R. 14–15). On April 30, 1939, 8,907 certificates were held by investors; on April 30, 1940, 9,350 certificates (R. 55, Stip. par. 17). During the fiscal years ending April 30, 1939, and April 30, 1940, sums were deposited to the credit of the trustee by the corporation aggregating respectively $712,676 and $630,143 (R. 14). These sums were used by the trustee to purchase stock and for the conversion of beneficial interests (R. 14).

The Tax Court concluded that the trust was not an association taxable as a corporation (R. 20–21). The basis of its decision (R. 20) was that the

> proceeding is so essentially similar to *The Chase National Bank of the City of New York, as Trustee,* 41 B. T. A. 430, affirmed (C. C. A., 2nd Cir.), 122 Fed. (2d) 540, that we have no difficulty in concluding that the result reached should normally be the same.

The court below reversed (R. 290) and adhered to its prior decision in *Hamilton Depositors Corp.* v. *Nicholas,* 111 F. 2d 385, rehearing denied May 22, 1940, involving the same question as to this Hamilton Trust which arose in connection with the capital stock tax for the years 1933 to 1936.

ARGUMENT

1. Although the precise question of whether an investment trust is an association taxable as a corporation has never been decided by this Court, the principles to be followed in determining the answer are clearly set forth in *Morrissey* v. *Commissioner,* 296 U. S. 344; *Swanson* v. *Commissioner,* 296 U. S. 362; *Helvering* v. *Combs,* 296 U. S. 365; *Helvering* v. *Coleman-Gilbert,* 296 U. S. 369; and *Lewis & Co.* v. *Commissioner,* 301 U. S. 385. This Court denied the petition for a writ of certiorari in *Pennsylvania Co. for Insurances, etc.* v. *United States,* 138 F. 2d 869 (C. C. A. 3d), certiorari denied, 321 U. S. 788 (see Nos. 691 and 692, October Term, 1943), which presented many of the contentions raised here as to investment trusts. The decision below does not conflict with the principles established by this Court in the *Morrissey* case, *supra.* The trust was used by a large number of persons in association as a medium for conducting a business enterprise and for the sharing of its gains and not merely as a means of conserving property. The essential attributes of this trust closely resemble those of the corporate form. The management of this joint enterprise, acting in behalf of a large group of associated persons, is centralized; the entity is a continuing one and the period of trust perpetual (R. 167); the interests of the

participants, represented by certificates similar to shares of corporate stock, are transferable; the continuity of the trust is not affected by death among the beneficial owners; and the personal liability of participants is limited to property invested in the undertaking.

The record contains abundant evidence of the commercial character of this enterprise and establishes clearly its role as a profit-making medium, rather than as a traditional trust, primarily intended for the conservation of property. See, for example, "Exhibit 4, Prospectus, The Hamilton Investment Plan," filed with the Securities and Exchange Commission, effective date October 19, 1939. (R. 137–169.)

Petitioner's contention (Br. 26) that beneficial ownership of the underlying assets by the investors negates all possibility of corporate resemblance was fully answered by the court below (R. 289), which noted that the legal title to the securities is in the trustee as is the title to the income and profit in the first instance. As that court pointed out, thefact that when the trustee receives income from the underlying securities, its receipt creates a corresponding indebtedness to the individual beneficiary and that the beneficial interest is in the beneficiaries is not decisive of the nature of the enterprise. The fact that the investors have no power to vote the shares in the portfolio (R. 122, par. 16) is at least of equal significance as one instance of the manner

in which the trustee is more than a conduit. But what is decisive in this case is the use of this device as "a medium for the carrying on of a business enterprise by the trustees and participation in the profits by numerous beneficiaries whose interests were represented by transferrable share certificates, thus permitting the introduction of new participants without affecting the continuity of the plan." *Lewis & Co.* v. *Commissioner,* 301 U. S. 385, 388. No doubt has been expressed by courts dealing with investment trusts that that form of enterprise meets, in this particular, the "corporate form" test prescribed by the *Morrisey* case. There can, therefore, be no conflict between the lower court's ruling and *Central Life Assur. Soc., Mut.* v. *Commissioner,* 51 F. 2d 939 (C. C. A. 8th), and *112 West 59th Street Corp.* v. *Helvering,* 68 F. 2d 397 (App. D. C.), neither of which was concerned with investment trusts.

The petitioner also contends that the decision of the court below is in conflict with the decision of the Second Circuit Court of Appeals in *Commissioner* v. *Chase Nat. Bank,* 122 F. 2d 540, and with that of the Ninth Circuit in *Commissioner* v. *Buckley,* 128 F. 2d 124. Unless the basis of the asserted conflict is a contention that investment trusts, generally, are not taxable, a view which has been accepted by no court, we submit that the provisions of the trust agreement in this case differ substantially from those in the agreements in-

volved in the *Chase Nat. Bank* and *Buckley* cases. In neither case was the trustee or the corporation given the power, present here, to reinvest proceeds of stock eliminated under the plan. There was no broad and unlimited discretion such as the trust declaration here provides, empowering the corporation to eliminate securities. Actually the power of elimination and reinvestment in this case affords the corporation, acting in conjunction with the trustee, substantial powers of management by which the contents of the portfolio as a whole and the undivided interest of each investor may be radically altered (R. 123–124). In addition, the power of the corporation to propose a complete revamping of the portfolio when business conditions warrant (R. 135; par. 64), though not identical with the power to substitute securities present in *Commissioner* v. *North American B. Trust,* 122 F. 2d 545 (C. C. A. 2d), must lead to the same result. In that case, which was decided at the same time as the *Chase Nat. Bank* case, the Circuit Court of Appeals for the Second Circuit held that the trust was an association. We believe, therefore, that the court below properly held that there was no conflict.

As observed by this Court in the *Morrissey* case, *supra,* p. 356:

> * * * it is impossible in the nature of things to translate the statutory concept of "association" into a particularity of detail that would fix the status of every sort of

> enterprise or organization which ingenuity may create, * * *.

See, also, *Pennsylvania Co. for Insurances, etc.* v. *United States, supra.* We submit that the criteria propounded by this Court in the *Morrissey* case, *supra,* and elaborated by the Treasury Regulations (Appendix, *infra,* pp. 14–19) have been properly applied by the court below to the precise facts of this case.

2. The court below did not err in reviewing the decision of the Tax Court. The question in no way resembles that involved in *Dobson* v. *Commissioner,* 320 U. S. 489, rehearing denied, 321 U. S. 231. The facts are not in dispute and the decision of the Tax Court on the question of the classification of an entity as an association or a strict trust under the statute is a question of law which may be reviewed on appeal.[1] Cf. *Security Mills Co.* v. *Commissioner,* 321 U. S. 281. Compare *Helvering* v. *Combs, supra,* where this Court reversed a decision of the circuit court of appeals which had affirmed the holding of the Board of Tax Appeals that an enterprise was not an association.

That the ruling in this case is of the type that is reviewable is evident, for the Tax Court rested

[1] Contrary to the petitioner's assertion (Pet. 10, 17–18), the question before the Tax Court and the circuit court of appeals was not the determination of whether a series of transactions should be treated separately or as one for tax purposes. The question whether a trust is an association involves no such problem.

its decision solely upon (R. 21) the belief that this case involved "a principle to which the Board has committed itself and in which it was there upheld on review" in *Chase National Bank* v. *Commissioner,* 41 B. T. A. 430, affirmed, 122 F. 2d 540 (C. C. A. 2d). The Tax Court pointed out further that it "subsequently reaffirmed its position in an unpublished opinion and [had] again been affirmed by a different circuit" in *Commissioner* v. *Buckley, supra.* Indeed, it appears clear that the Tax Court itself considered the final question as one of statutory construction subject to judicial review when "with the greatest deference" (R. 21) to the Tenth Circuit Court of Appeals, which had previously held this in-

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[2] *Hamilton Depositors Corp.* v. *Nicholas*, 111 F. 2d 385, rehearing denied May 22, 1940. The decision in this case would have been controlled under the principle of *res judicata*, by *Hamilton Depositors Corp.* v. *Nichols*, *supra*, except for the technicality that the action in the earlier case was brought against a Collector of Internal Revenue, whereas the Commissioner of Internal Revenue is respondent in this proceeding (R. 21). See *United States* v. *Nunnally Investment Co.*, 316 U. S. 258. The rule in the *Nunnally* case is no longer applicable (Internal Revenue Code, Section 3772 (d) (26 U. S. C. 3772), as amended by Section 503, Revenue Act of 1942, c. 619, 56 Stat. 798), and had the present proceeding, in fact, been instituted after June 15, 1942, instead of, as it was, on February 1, 1941 (R. 277), the principle of *res judicata* would have applied and the Tax Court would have been bound by the decision of the circuit court of appeals in the cited case.

vestment trust an association,[2] it refused to follow that decision, saying (R. 21):

> It will not improve the situation for us to follow diametrically opposite views depending upon the circuit to which an appeal will lie.

The problem in this case is not one of accounting, and, moreover, the ruling of the Tax Court cannot be reconciled with the Treasury Regulation provision (Art. 901–2, Appendix, *infra*, p. 15) that investment trusts are taxable as corporations. It was, therefore, "not in accordance with law" and is subject to review under the decision in the *Dobson* case, 320 U. S. at 492.

## CONCLUSION

The decision of the court below is correct, and there is no conflict of decisions. The court below did not exceed its judicial authority in reviewing the decision of the Tax Court in this case. The petition for a writ of certiorari should be denied.

Respectfully submitted.

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